

Sanitized Copy Approved for Release 2011/01/24 : CIA-RDP85T01058R000608510001-6

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DATE 1/3/86
DOC NO SOVM 85-10222
OCR CYS 3
P&PD CY 1

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Central Intelligence Agency

Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

26 December 1985

**Leadership Intentions to Raise Prices on
Basic Foodstuffs and Rents**Summary

Recent expressions of concern over the low and highly subsidized retail prices for several basic foods and of rents in the Soviet press and by Gorbachev himself raise the possibility that the regime may drop its long-held policy of stable official prices for consumer "necessities." Past regimes have failed to follow through on hints of impending price increases, reflecting apprehension over adverse popular reaction to higher prices. Price hikes, however, would be in line with Gorbachev's policy of emphasizing improvements in economic efficiency and he may show more mettle than his predecessors in risking the heightened popular discontent price increases may bring. [redacted]

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The immediate impact of price increases would depend on whether prices were raised enough to restore balance between supply and demand in consumer markets and soak up excess purchasing power which prevails for some consumer goods at existing prices. If Gorbachev raises prices by less, he could have the worst of all possible worlds--an insignificant reduction in queues and the associated losses in work time together with an antagonized populace. Gorbachev could reduce the risk of popular discontent by accompanying any substantial rent or food price hikes by increases in wages of low paid workers and in pensions. He would have to package wage and price hikes carefully, however, in order to be both "efficient" and "fair." The importance of price hikes in the long run would depend on whether such increases signal adoption of a more flexible price policy on an ongoing basis targeted at reducing supply-demand imbalances in consumer markets or whether they are a one shot boost to be followed by continued rigidity over a long period of time. The extent to which the leadership acts on its evident belief that prices of "necessities" should be raised will reflect Gorbachev's assessment of the benefits of greater economic efficiency to be gained by such a move versus the costs of greater popular discontent. [redacted]

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There have been several indications in recent weeks that Gorbachev may be considering increases in rents and prices of some basic foodstuffs. Such a move would be a departure from the long-held policy of stable consumer prices for "necessities", often touted by the Kremlin as a key manifestation of Soviet social welfare policy. Rents, for example, have been constant since 1928, and bread prices were last increased in 1955. State retail prices of meat and butter were last raised in 1962. Meanwhile, rents cover only a tiny fraction of housing costs and bread and livestock prices at retail are one-third to one-half of the costs to state owned production units.

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Gorbachev in a recent major speech in Tselinograd hinted at the possibility of price hikes. The General Secretary mentioned that demand for some foods exceeded supply at existing prices which, he noted, have not been changed for twenty years. He spoke of the extensive state subsidies on the retail price of meat, amounting to some 20 billion rubles a year.¹ Gorbachev singled out the waste and misuse of bread resulting from the low level of prices as an especially serious problem. He cited workers' letters sent to the Central Committee decrying the feeding of bread to livestock and stated that such uneconomic practices must be dealt with. "We must tackle this problem head on...Our common concern is resolutely to change attitudes towards bread and indeed to other food products."

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¹ Total subsidies on foodstuffs amounted to almost 45 billion rubles in 1984, some 12 percent of all expenditure from the state budget and almost as much as was invested in agriculture. These subsidies reflect the difference between the cost to the state of purchasing foodstuffs from the farms and the prices paid by consumers in the retail trade network for the same goods.

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[redacted] specialist at the USA-Canada Institute, recently told US embassy officials that he would not be surprised by an increase in bread prices before the 27th Party Congress. He said that people have been writing letters to newspapers denouncing the waste that results from low bread prices. However, he foresaw no extensive overhaul of food prices in the near future since, in his opinion, people "will only accept" higher prices if improvements in the quality of foodstuffs, particularly meat and produce, are made. [redacted]

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An article published in Pravda in September recommended increases in apartment rents. Highly subsidized rents account for only about 3 percent of average household expenditures.

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The recently released drafts of the Party Program and the Twelfth Five Year Plan also contain hints of future price hikes. Specifically, the guidelines--repeating phrasing in the Party Program--stated that prices are to "more accurately reflect the level of socially necessary expenditures as well as the quality of products and services". This is in sharp contrast to a statement in the guidelines of the 1981-85 plan that "a policy of insuring the stability of state retail prices for basic foodstuffs and nonfood goods will be consistently pursued."

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A Pravda article published in December calls for changes in prices of consumer and producer goods. The author cites Marxist theory as well as the Party Program mentioned above as justification for revising prices to better reflect product

quality and consumer demand. The article implies that prices should be raised on consumer goods in short supply at existing low prices. It says that if the quantity of an article demanded exceeds the quantity supplied then the "social use value" on which prices should be based will rise, requiring an increase in price. The author argues that better balance in markets is needed for improvements in economic efficiency. No recommendation is made, however, to decentralize price setting i.e., the article assumes prices will continue to be centrally determined.

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A September edition of Izvestiya also carried a frank discussion of pricing problems. The article calls for a restructuring of state retail prices which currently don't reflect product quality, costs, or consumer demand. The chairman of the State Price Committee (Gostsen) N.T. Glushkov, a long time champion of stable retail prices for basic goods, is quoted in the article as saying, "We have the right to alter prices up and down if mistakes or abuses have occurred." Glushkov's statement was not accompanied by the promises of continued stability in retail prices for "necessities" which were typical of his previous discussions of retail price policy. The authors recommended increases in retail prices as an instrument for soaking up excess purchasing power and thereby easing the problems associated with repressed inflation. They note that retail prices overall have risen only slightly in the last twenty years while wages and other income have risen substantially.

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Increases in availability have been insufficient to prevent a growing imbalance between supply and demand.²

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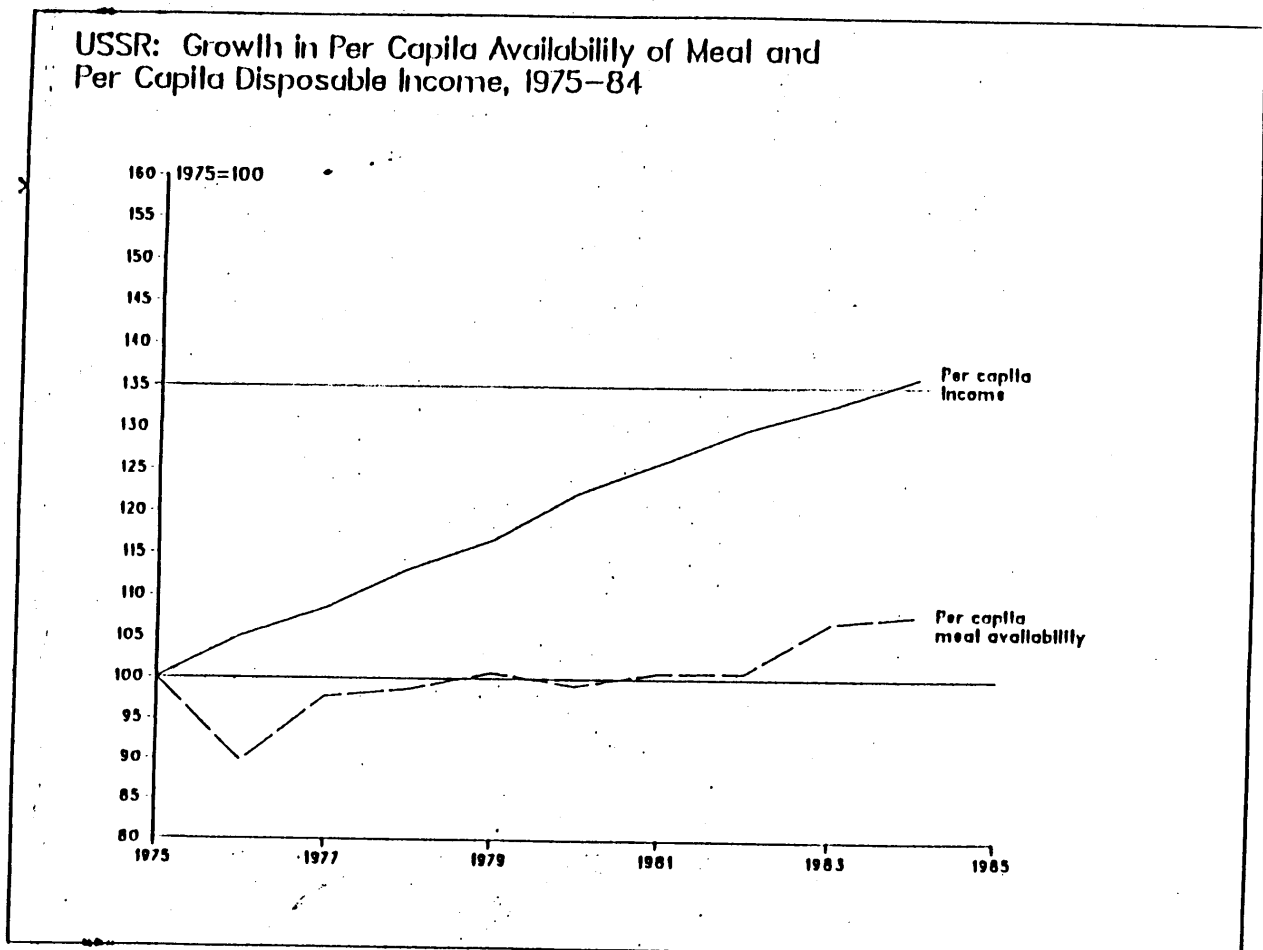
The authors' statements concerning the stability of retail prices are somewhat misleading. Although the official prices for specific goods have remained unchanged for an extensive period of time, changes in the mix of goods offered for sale along with increased sales in cooperative markets have effectively raised the cost of living. In specific, higher prices result from:

- greater imports of foodstuffs which are more expensive than domestic goods.
- changes in the mix and quality of foods offered for sale. For example, consumers often cannot find the cheapest type of bread although higher priced categories are regularly stocked. Also, genuine improvements in the quality of foods--due to an increase in the share of industrially processed foods, for example--have raised average food prices.
- an increase in the share of goods purchased through cooperative marketing channels, where prices are higher.
- artificial price hikes in state retail outlets due to such subterfuges as modifying an existing product in inconsequential ways, calling it a "new product," and charging a substantially higher price for it. For

² Although the authors criticized the complex bureaucratic procedures involved in price setting-- arguing that new simplified methods do not go far enough--they seem to stop short of advocating any move towards market pricing. They emphasize that it is up to Gostsen to make needed changes in prices and the pricing mechanism.

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example, repackaging of foods is one means of justifying a boost in food prices.³

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Nonetheless, the rise in average prices paid for selected foodstuffs has not been sufficient to soak up demand for these products.⁴ Indeed, growth in incomes has outpaced growth in availability of many quality foodstuffs, e.g. meat. For example, per capita disposable income in 1984 was 28 percent higher than in 1975 while per capita availability of meat was only 8 percent higher. (see figure) The excess demand for quality foods is also reflected in prices at the collective farm markets (CFMs) where prices vary according to supply and demand. Prices paid in CFMs are on average some two to four times the state retail prices.⁵

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One result of these supply-demand gaps has been widespread queuing that is at the cost of workers absenting themselves from their jobs. The regime has taken measures to combat such waste of labor time; in many locales formal rationing has been

³ Average rents paid by consumers have increased in a similar fashion. Thus, although the basic rental charge per square meter of housing has remained unchanged since 1928 (for housing constructed before 1925 and not renovated) higher rates are charged for housing which is newer, renovated, or more centrally located.

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⁴ Recent work by the Office of Soviet Analysis suggests that food prices in the state and cooperative trade network and in collective farm markets in 1984 were some 19 percent higher than in 1975.

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⁵ Part of the price difference reflects the superior quality of the products sold in CFMs. But even assuming that quality differences might account for as much as half of the price differential, supply-demand imbalances have put considerable upward pressure on free market prices.

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instituted. Furthermore, Moscow has increased special distribution of foodstuffs at the workplace, a move that not only cuts down on queuing by workers but also--by assuring them of the availability of select items-- appeases key elements of the labor force.

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Discussion of the need to raise retail prices and/or rents is not new. Articles in Sovietskaya Rossiya and Kommunist in early 1983 called for increases in bread prices. Pravda in September 1982 brought up the possibility of rent hikes. No action was taken, however. General Secretary Andropov, during a January 1983 speech at the Ordzhonikidze Machine Tool Factory, said that "the path of raising prices...does not suit us as a general one although it must be said we do have distortions and incongruities in prices and we must eliminate them." His comments were followed by retail price hikes in February on construction materials sold through the retail trade network to consumers and on services and other goods. There was no overhaul of prices on basic foodstuffs or rents under the Andropov regime, however.

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The regime in recent years has been loath to remove subsidies for basic commodities because of concern about the potential impact on popular attitudes and behavior. Soviet leaders realize that the provision of consumer necessities at low prices is something the population has come to regard as a de facto "right." Any increase in rents also runs the risk of arousing popular discontent given the small fraction of consumer expenditures allocated to rents as well as the continued

stability of rents for decades. Many leaders probably fear that any action that jeopardized consumer welfare could damage regime legitimacy. They well remember the largescale rioting that took place in the city of Novocherkassk following price increases on meat products in 1962. And they are fully cognizant that price hikes in Poland in July 1980 set in motion the chain of events that led to the formation of Solidarity a few weeks later. []

Nevertheless, Gorbachev has strong incentives to boost prices and rents as part of his overall drive to improve economic efficiency, including:

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- concern with a recent surge in consumer purchasing power created by restrictions on alcohol sales.⁶ The regime would probably like to reduce queuing, which is costly to the state in terms of work time lost.
- desire to cut back on the uneconomic and wasteful use of bread. We estimate that in recent years some 3-4 million tons of bread has been fed to livestock annually, equal to about 8-10 percent of total sales of bread products through the state and cooperative trade network in 1984.
- an effort by Gorbachev to reinforce his image as a reformer willing to make tough but necessary decisions to improve economic performance and reduce waste. []

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The immediate impact of a rise in prices of basic goods would depend on the magnitude of the increases, i.e., whether

⁶ Sales of alcoholic beverages accounted for some 18 percent of total retail sales in 1984 and about 36 percent of retail food sales. []

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prices were raised enough to restore balance between supply and demand. If Gorbachev raises prices by less, he could have the worst of all possible worlds--an insignificant reduction in queues and the associated losses in work time and simultaneously an antagonized populace. Gorbachev could reduce the risk of popular discontent by accompanying any substantial rent or food price hikes by increases in wages of low paid workers and in pensions. He would have to package wage and price hikes carefully, however, in order to be both "efficient" and "fair". The importance of price hikes in the long run would depend on whether such increases signal adoption of a sustained flexible price policy on an ongoing basis targeted at reducing supply-demand imbalances in consumer markets or whether they are a one shot boost to be followed by continued rigidity over a long period of time.

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The regime might initially settle for a small increase in bread prices, given the general acknowledgement that the misuse of bread for livestock feeding is widespread. Price hikes on other staples--where there is no such acknowledgement--would be more contentious. Public reaction to any increase in the price of bread--should such an increase occur--could well determine whether the regime would push ahead with further boosts in the prices of staples.

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Gorbachev has adopted, or is considering, a number of revisions in the tacit "social contract" that developed between state and society during the Brezhnev years. The unspoken terms of this "contract" were that the regime provided material

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security and tolerated low worker output in exchange for political quiescence on the part of the population. Gorbachev-- by acting to curtail alcohol consumption, tighten worker discipline, and limit the population's access to higher education, and by discussing measures to reduce job security--is moving toward a domestic strategy that places heavier demands on the population and guarantees fewer benefits. An increase in prices and rents would constitute a further move in this direction and would suggest a political calculation that the potential gains in economic efficiency outweigh the risk of heightened popular discontent.

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